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SUBJECT: JAMAICA: CAUGHT IN A DEBT TRAP-- CENTRAL BANK GOVERNOR
RESIGNS; IMF SOLUTION?

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Summary

¶1. (SBU) The resignation of the Governor of the Central Bank, Derick Latibeaudiere, during the middle of an International Monetary Fund (IMF) negotiations may be a sign that the time has come for the Government of Jamaica (GOJ) to face the severity of the situation and negotiate a solution with private holders of Jamaican debt, a resolution referred to as a "debt operation" by the IMF. On November 2 the Standard and Poor's rating agency downgraded Jamaica to CCC from CCC plus in response to Latibeaudiere's departure fearing the likelihood of selective default. Jamaica holds the unenviable record of being among the most indebted countries in the world, with a debt-to-GDP ratio of 108 percent. At the end of July 2009, the country's stock of public debt stood at USD 14.2 billion, which means that each Jamaican's share of debt is about USD 5,260, in a country with a per capita income of less than USD 4,500. Most of the debt load arose over a seven year period due to persistent fiscal deficits as well as the take-over of government guaranteed debt. Over the same period, there was a marked shift in borrowing from multilaterals to private creditors, with a majority of the country's debt now owed to Jamaican residents. This, combined with Jamaica's proud record of never defaulting on debt, makes any prospect of an involuntary debt solution daunting. However, the worsening fiscal dynamics combined with the continued contraction in GDP will make any further jump in the stock of debt increasingly unsustainable. Jamaica might therefore be forced to finally swallow its pride and embark on the politically and financially difficult path of debt restructuring. End summary.

The Raw Numbers

¶2. (SBU) Jamaica holds the unenviable record of being the fourth most indebted country in the world behind Zimbabwe, Japan, and Lebanon. At the end of July 2009, Jamaica's stock of public debt stood at USD 14.2 billion or 108 percent of GDP. Domestic debt accounts for USD 8 billion of the total debt, while external debt accounts for the remaining USD 6.2 billion. At this level, each Jamaican's share of the national debt amounts to USD 5,260, above the per capita income level of less than USD 4,500. The gargantuan debt places a huge burden on the country's limited resources, with almost 52 cents of every dollar of revenue collected by the Government of Jamaica (GOJ) being used to pay interest. Interest and principal payments together (total debt servicing) account for over 100 percent of revenues, forcing the GOJ to borrow to service debt; a clear warning sign of the chronic fiscal and debt challenges facing the country.

History of Debt

¶3. (SBU) Jamaica's insatiable appetite for debt had its genesis in the lost decade of the 1970s, when a combination of external and domestic policy-induced shocks set the stage for borrowing. Ironically, the 1970s oil crisis not only increased Jamaica's demand for funds to pay for the commodity, but also provided a willing cadre of lenders awash with oil revenues. Even worse, the country's foray into socialism and by extension distributive policies, led to persistent fiscal deficits and an erosion in output. By the end of the decade, the left-leaning Michael Manley-led government was forced to tap multilateral and bilateral lending agencies for loans in order to fill the gap in the country's finances.

Forming An Addiction

¶4. (SBU) The rising debt load accelerated in the 1980s, when the center-right Edward Seaga led-administration capitalized on the availability of highly concessionary loan facilities. This policy led to a doubling of the debt load to 212.4 percent of GDP by 1984. Of this amount, external debt accounted for 152.9 percent, up from 63 percent in 1980. However, unlike the previous period when output was declining, the latter part of the 1980s was characterized by robust economic growth and fiscal surpluses. The Peoples National Party (PNP)-led administration that followed from 1989 to 2007 also had a significant appetite for borrowing, but unlike the earlier decades when debt was sourced from the external market, this period saw a rapid acceleration of financial liberalization and the development of the domestic capital market.

Growth in Domestic Debt, Emergence of a Financial Crisis

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¶5. (SBU) The evolution of the domestic capital market was to open up a new borrowing option for a government now hooked on debt, due to the re-emergence of persistent fiscal deficits. Between 1996 and 2003, the national debt increased by 71 percentage points, with

the largest annual increase of 22 percentage points occurring in ¶2001. Several factors led to the growth of the debt during this period. Most importantly was the rapid development of the financial market, spurred on by liberalization in the sector. This led to an eventual collapse of the financial sector in the latter half of the 1990s. The GOJ opted to rescue failed financial entities including several key banks, insurance companies, and pension funds. The subsequent resolution of the financial crisis, commonly referred to as the Financial Sector Adjustment Company (FINSAC), resulted in the GOJ absorbing USD 3.1 billion in debt (41.2 percent of GDP), probably the most expensive resolution to a financial crisis worldwide in terms of cost to GDP.

Borrowing From Peter to Pay Paul

¶6. (SBU) Jamaica's burgeoning debt stock can also be attributed to the absorption of public sector liabilities, commonly referred to as contingent liabilities. Between 1996 and 2003 the GOJ absorbed USD 124.3 million (4.9 percent of GDP) in government guaranteed debt from public enterprises. Losses from the Bank of Jamaica (Central Bank) accounted for a further USD 187 million (8.7 percent of GDP) over the period. For the GOJ the single greatest contributor to the build-up in debt has been the practice of borrowing to service debt, due to persistent fiscal deficits over the years. These fiscal deficits, which are largely the result of the GOJ's failure to collect sufficient tax revenues to cover expenditures, have forced the government into the position of either rolling over debt when it comes due or borrowing from one set of creditors to pay another.

Who Holds The Debt?

¶7. (SBU) Since 1999 there has been a marked shift in borrowing from multilateral and bilateral lenders to domestic creditors. At the beginning of the 1990s over 75 percent of the total debt stock was owed to external lending agencies. However, by the end of the decade there was a dramatic reversal, with 60 percent of the debt stock owed to locals. There was also a shift within the external debt portfolio from official to private creditors. Even though these loans were sourced at much higher rates of interest, it was more attractive to the Patterson-led administration, which was bent on avoiding the scrutiny of the multilaterals. Patterson, a strong proponent of the Non-Aligned Movement, was also keen to pursue domestic policies and escape what he considered the "dictates of outsiders". The policy started with the much heralded ending of borrowing relations with the International Monetary Fund (IMF) in ¶1996. By the end of 2004 the GOJ had repaid its outstanding debt to the IMF. Bilateral debt also declined from USD 1.7 billion in 1996 to USD 0.6 billion at the end of 2008.

A Return to the Multilaterals

¶8. (SBU) The most dramatic shift in terms of the nature of the debt was the USD 3.8 billion movement in debt sourced from external private creditors in just over a decade. Although these bonds were

sold in the external capital market, they were immediately bought by Jamaicans on the secondary market. When the PNP's 18 year rule came to an end in August 2007, the new Jamaica Labour Party-led government opted for a major policy shift and returned to the multilaterals. Since 2007, the GOJ has secured cheaper loans from the multilateral lending agencies led by the Inter American Development Bank (IADB) and the World Bank (WB). The GOJ's timing was remarkably advantageous as it occurred just months before the worst global economic recession in decades and the tightening of credit worldwide. As the external capital market closed to Jamaica, the GOJ was able to source almost USD 1 billion from these institutions at concessionary rates of interest.

Possible Liability Management Program?

¶9. (SBU) The worsening fiscal dynamics led by declining revenues, has forced the GOJ to increase its appetite for domestic private debt. This pushed interest rates as high as 24 percent, thus further stifling access by private creditors at a time when credit is crucial to kick-start the moribund economy. The meteoric rise in domestic debt combined with the local ownership of external private debt also makes any prospect of a liability management program (a managed or technical default on debt) explosive within Jamaica. Add to this the country's proud and enviable record of never defaulting on debt, and the possibility of a radical solution appears less likely.

GOJ Gets Cold Feet, Shelves Debt Relief Plan

¶10. (SBU) During August of 2009, on the back of a downgrade from ratings agency Standard and Poor's (S and P), the GOJ retreated from a voluntary liability management program offered by local financial institutions (REFTEL A). In its analysis the S and P stated that the offer had the smell of a default, which set off concerns within the GOJ. The initiative was aimed at relieving the GOJ's short-term debt service costs by exchanging high-cost debt on a voluntary basis for debt with lower rates of interest. Minister of Finance and the Public Service Audley Shaw in a press release stated that Cabinet had taken a decision not to pursue this option, stating, "Cabinet, after careful consideration of the proposal and mindful of the uncertainty in the market, has decided that the Government will not be pursuing this proposal." The move would have provided the GOJ with some financial breathing room in the near term, since the GOJ did not pursue the option it was forced to increase its allocation to interest payments by USD 182 million, in the recently tabled Supplementary Estimates (REFTEL B). This brought the overall allocation of interest payments for fiscal year 2009/10 to USD 2 billion or almost half of the entire recurrent budget. It also represents a 30 percent increase on the amount allocated last year, further highlighting the debt conundrum facing Jamaica.

Point Of No Return

¶11. (SBU) The general consensus appears to be that the time has

come for the GOJ to face the severity of the situation and negotiate a solution with private holders of Jamaican debt, a resolution referred to as a "debt operation" by the IMF (REFTELS C, D, E). So firm is the IMF in its conviction, that Director of Fiscal Policy at the Ministry of Finance, Courtney Williams confirmed to Emboffs that this issue is a potential deal breaker in the country's current negotiation for a USD 1.2 billion Stand-By Agreement. Williams said that although the IMF is pleased with all the other concessions made by the GOJ, they are still awaiting a replacement for the failed liability management program, as a viable solution needs to be found to the debt predicament. Barclay's Capital, a New York-based division of Barclays Bank, has also weighed in on the country's debt plight, suggesting that Jamaica is approaching the "point of no return" and that it will take more than fiscal adjustments to regain long-term sustainability. The investment bank is proposing that the GOJ should seek the help of the IMF to restructure its debt instead of seeking another loan to merely postpone the country's agony.

Head of Central Bank Steps Down

¶12. (SBU) Derick Latibeaudiere, the Governor of the Bank of Jamaica, who has been staunchly opposed to any form of debt restructuring, resigned (possibly was forced out) on October 30 in the middle of a visit by representatives from the IMF. His departure could open the door to a possible debt operation with the IMF. On November 2, the S and P downgraded Jamaica to CCC from CCC plus in response to Latibeaudiere's departure fearing the likelihood of selective default.

Former Russian Official Weighs In

¶13. (SBU) The most radical suggestion to date has come from the former Russian Finance Minister, Alexander Livshits. Speaking to a group of Jamaican businessmen in Kingston, the former Minister argued that the time had come for the GOJ to commence negotiations with the London Club of creditors to bring its debt under control. Livshits, who oversaw a similar arrangement while he was Minister, stated that Jamaica already is experienced in dealing with the Paris Club having negotiated similar agreements in the past. He suggested that after the restructuring process, the debt should be capped and new borrowing limited to cheaper funds. "There should be a special Government decision or, better, a law establishing a long-term framework for new borrowing", he continued. He opined that ultimately Jamaica will only rid itself of a heavy debt burden in the medium-term if it generates economic growth by investing in projects such as those leading to cheaper energy. (NOTE: Livshits currently represents UC Rusal, whose bauxite operations in Jamaica have ceased operations due to high domestic energy cost. END NOTE)

Comment

¶14. (SBU) After years of mortgaging the country's future to satisfy its insatiable appetite for debt, even the GOJ now appears to be coming to the realization that the current debt dynamics are unsustainable. Ever mindful of guarding its reputation of never defaulting on debt, the GOJ has been slow to take the necessary measures to address its unsustainable debt problems. This was most evident when the GOJ shunned the opportunity to gain some relief under a debt liability management program. The JLP-led government knows a debt restructuring move will be both politically and financially explosive because a large portion of the external private debt is held by Jamaican creditors. Apart from hurting domestic creditors and possibly financial sector stability, any attempt to address debt could also drive savvy investors to switch to foreign assets, creating the unwelcome problem of foreign exchange market instability. However, despite the possible short-term ramifications, it would appear that radical surgery in the form of a debt operation will be required to address the debt problem and to provide the economy with a fighting chance for recovery and growth. The GOJ cannot afford to attempt to muddle through - otherwise, it might well lead to strangulation by debt. End Comment.
Parnell